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 14 Chapter 11 Trustee

15 **UNITED STATES BANKRUPTCY COURT**  
 16 **EASTERN DISTRICT OF CALIFORNIA**  
 17 **SACRAMENTO DIVISION**

18 In re: ) **Case No. 09-29162-D-11**  
 19 SK FOODS, L.P., a California limited )  
 20 partnership, ) Chapter 11  
 21 Debtor. ) **DC No. TRM-1**

22 In re : ) **Case No. 09-29161-D-11**  
 23 RHM INDUSTRIAL/SPECIALTY FOODS, )  
 24 INC., a California Corporation, d/b/a Colusa ) Chapter 11  
 25 County Canning Co., ) **DC No. TRM-1**  
 26 Debtor. )

27 **CHAPTER 11 TRUSTEE'S OBJECTION**  
 28 **TO MOTION OF ALLIED WORLD**  
**NATIONAL ASSURANCE COMPANY**  
**AND ALLIED WORLD ASSURANCE**  
**COMPANY (U.S.) FOR RELIEF FROM**  
**THE AUTOMATIC STAY**

Date: June 23, 2010  
 Time: 10:00 a.m.  
 Place: Courtroom 34  
 501 I Street, 6th Floor  
 Sacramento, CA  
 Judge: Hon. Robert S. Bardwil

Bradley D. Sharp (the “Trustee”), the duly appointed and acting chapter 11 trustee for SK Foods, L.P., a California limited partnership (“SK Foods”), and RHM Industrial/Specialty Foods, Inc., a California corporation, d/b/a Colusa County Canning Co. (“RHM” and collectively with SK Foods, the “Debtors”), herby submits this Objection to the Motion of Allied World National Assurance Company and Allied World Assurance Company (U.S.) for Relief from the Automatic Stay [Docket No. 1784] (the “Motion”), and in support thereof, states as follows:

### **BACKGROUND**

1. On May 5, 2009 (the “Petition Date”), involuntary bankruptcy petitions were filed against Debtors SK Foods and RHM. Thereafter, on May 7, 2009, the Debtors filed a voluntary petition for relief (the “Bankruptcy Case”) under chapter 11 of Title 11 of the United States Code, 11 U.S.C. § 101, et. seq. (the “Bankruptcy Code”).

2. On May 18, 2009, the Trustee was appointed the chapter 11 trustee in the Bankruptcy Case and presently serves in that capacity. On June 18, 2009, this Court ordered the involuntary cases each be substantively consolidated with this Case No. 09-29161 and Case No. 09-09162, respectively, and set forth that the petition dates for each of the consolidated cases shall be May 5, 2009, with the date of the order of relief as May 7, 2009.

3. On May 12, 2010, the Trustee, the Official Committee of Unsecured Creditors (the “Committee”), and the Bank of Montreal, as agent for the Debtors’ prepetition secured lenders, filed their proposed Joint Chapter 11 Plan of Liquidation (the “Plan”) and Disclosure Statement. A hearing on the Motion to Approve the Disclosure Statement is currently scheduled for June 23, 2010.

4. The Debtors purchased certain “claims made” directors and officers and employment practices insurance policies from Allied World National Assurance Company (“Allied World”) and Allied World Assurance Company (U.S.) Inc. (“AWAC” and together with Allied World, “Allied”). Specifically, Allied World issued For Private Companies Policy No. CO11427/001 to S.K. Foods PM Corp. for the February 19, 2009 to February 19, 2010 Policy Period (the “Primary Policy”). In addition, AWAC issued Excess Directors & Officers Liability

1 Insurance Following Form Policy No. CO 11818/00 1 to S.K. Foods PM Corp. for the April 8,  
2 2009 to February 19, 2010 Policy Period (the "Excess Policy") and together with the Primary  
3 Policy, the "Policies"). The Debtors are named insureds under these Policies.

4 5. Allied is now seeking relief from the automatic stay to commence litigation (the  
5 "Rescission Action") related to the Policies in a non-bankruptcy forum against the Debtors, other  
6 insureds, and two former officers of the Debtors.

### 7 ARGUMENT

8 6. The automatic stay is one of the fundamental protections afforded to debtors  
9 under the Bankruptcy Code. *See Midatlantic Nat'l Bank v. New Jersey Dep't of Env'tl*  
10 *Protection*, 474 U.S. 494, 503 (1986). The automatic stay provisions operate primarily to "stop  
11 all creditor collection efforts, stop all harassment of a debtor seeking relief, and to maintain the  
12 status quo between the debtor and his creditors, thereby affording the parties and the Court an  
13 opportunity to appropriately resolve competing economic interests in an orderly and effective  
14 way." *Taylor v. Slick*, 178 F.3d 698, 702 (3d Cir. 1999) (citation omitted); *see also Benedor*  
15 *Corp. v. Conejo Enterprises, Inc. (In re Conejo Enterprises, Inc.)*, 96 F.3d 346, 351-52 (9th Cir.  
16 1996).<sup>1</sup>

17 7. One key objective of the automatic stay is to forestall the depletion of the debtor's  
18 assets due to legal costs in defending proceedings against it, and in general, to avoid interference  
19 with the orderly liquidation or rehabilitation of the debtor. *In re Rexene Prods. Co.*, 141 B.R.  
20 574, 576 (Bankr. D. Del. 1992).

21 8. Allied requests relief from the automatic stay pursuant to section 362(d)(1) of the  
22 Bankruptcy Code, which provides that "[o]n request of a party in interest and after notice and a  
23 hearing, the court shall grant relief from the stay provided under subsection (a) of this section . . .

24  
25 <sup>1</sup> The automatic stay broadly extends to all matters that may have an effect on a debtor's  
26 estate, enabling bankruptcy courts to ensure that debtors have the opportunity to  
27 rehabilitate and reorganize their operations. *See e.g., In re S.I. Acquisition, Inc.*, 817 F.2d  
28 1142, 1146 (5th Cir. 1987) (stating that the automatic stay "imposes a moratorium on all  
actions against the debtor or its property and assets" and thereby "ensures a respite for the  
debtor so that it may attempt to reorganize or decide to liquidate and promotes the  
overriding bankruptcy policy of equal distribution of a debtor's assets among creditors").

(1) for cause.” The Bankruptcy Code does not define “cause” for purposes of section 362(d)(1). Whether “cause” exists is committed to the sound discretion of the Bankruptcy Court and is determined on a case-by-case basis.” *See Conejo Enterprises*, 96 F.3d at 352; *see also Christensen v. Tucson Estates, Inc. (In re Tucson Estates, Inc.)*, 912 F.2d 1162, 1166 (9th Cir. 1990); *Santa Clara County Fair Ass’n v. Sanders (In re Santa Clara County Fair Ass’n)*, 180 B.R. 564 (B.A.P. 9th Cir. 1995). “Exercising discretion in determining cause for stay relief requires the balancing of hardships and consideration of the totality of the circumstances.” *In re Avila*, 311 B.R. 81, 83-84 (Bankr. N.D. Cal. 2004).

9. To obtain relief from the automatic stay, the party seeking relief must first establish a prima facie case that “cause” exists for relief under section 362(d)(1). *Truebro, Inc. v. Plumberex Specialty Prods., Inc. (In re Plumberex Specialty Prods., Inc.)*, 311 B.R. 551, 557 (Bankr. C.D. Cal. 2004). If the movant establishes a prima facie case, the burden shifts to the debtor to show that relief from the automatic stay is unwarranted. *Id.* “If the movant fails to meet its initial burden to demonstrate cause, relief from the automatic stay should be denied.” *Id.* Because Allied has failed to establish cause, the Court should deny the Motion.

**A. The Stay Is Not Prejudicing Allied’s Interests In Any Meaningful Way**

10. To the best of the Trustee’s knowledge, no proceeding is pending under which Allied could be compelled to cover any claim made under the Policies. Allied admits in ¶63 of its draft rescission complaint that it denied coverage in the *Estrada* action and fully reserved its rights. *See* Rescission Complaint at ¶63. While it is true that the Trustee put Allied on notice last July of the estate’s possible claims (in order to preserve the estates’ rights to tender claims after the policies terminated), Allied has denied coverage. Since then, the estate has not taken any affirmative action to force Allied to honor the Policies and/or pay any claims. Nor is the Trustee aware (and Allied has not shown) that any other insured or claimant under the Policies has commenced an action to compel Allied to honor its obligations thereunder. Moreover, Allied is not, as far as the Trustee can tell, paying for the defense of any claim that may be covered under the Policies. And finally, Allied is not at imminent risk of losing its rights to pursue a rescission action against any of the non-debtor parties as the limitations period for its proposed

1 Rescission Action is four years. *See* Cal. Civ. Proc. Code § 337.

2 11. In short, Allied has not shown that its coverage declinations are not sufficient to  
3 protect it from having to pay claims under the Policies, it has not shown that it will be subjected  
4 to any liabilities (such as advancing defense costs), or that its interests will otherwise be  
5 prejudiced if the stay remains in effect.

6 **B. Lifting The Stay Will Prejudice The Estate**

7 12. Allied contends that the “Debtors will not be prejudiced by the litigation of the  
8 Rescission Action in a non-bankruptcy forum.” (Motion, p. 8 at 1-2). This characterization is  
9 simply inaccurate. As noted above, one purpose of the stay is to prevent the estate’s assets from  
10 being depleted by having to expend resources defending claims made against it. *Rexene Prods.*  
11 *Co.*, 141 B.R. at 576. This consideration is particularly applicable in this case.

12 13. Allied’s asserted basis for rescinding the Policies is intensely factual in nature  
13 over which there is likely to be a significant dispute. (For example, when, exactly, did Gallagher  
14 & Co. provide the financial statements to Allied, and had SK Foods been informed by its  
15 auditors that such information was unreliable and required restatement by that time? What,  
16 exactly, did Lisa Crist and Mark McCormick say to Allied’s representatives at the January 30,  
17 2009 meeting, and did they know that the Bank Group would not extend the line of credit?) But  
18 whatever the merits of Allied’s claims that it was fraudulently induced to issue the Policies,  
19 lifting the stay will force the estate to incur significant attorneys fees to preserve the estate’s  
20 rights under the Policies *before* it is clear that the estate will be benefitted from this expenditure  
21 of funds.

22 14. At this juncture, the Trustee has named only one individual, Scott Salyer, in a  
23 breach of fiduciary duty lawsuit that would fall within the Policies’ insuring clauses. The  
24 proposed Plan contemplates assignment of the breach of fiduciary duty claims against Salyer,  
25 and potential claims against other officers of certain insureds to the Bank Group. *See* Joint Plan  
26 of Liquidation (dated May 12, 2010) at Art. 4.1<sup>2</sup> [Doc. No. 1714] The Plan also contemplates

27 <sup>2</sup> The Plan proposes to assign “Independent Claims and Causes of Action” to the Bank  
28 Group, which is defined to include the breach of fiduciary duty action against Salyer, and  
...Continued

1 that the Liquidating Trust will have to reimburse the Bank Group if more than certain amounts of  
2 the Banks' cash collateral is used. *See* Plan at Art. 5.2, 5.3, and 10.2. Thus, if the stay is lifted  
3 now, the estate and/or the liquidating trust may incur costs that wind up benefitting the Bank  
4 Group alone.

5 15. Moreover, to the extent the estate and/or liquidating trust retains claims against  
6 other former officers or directors besides Salyer, no litigation is pending seeking to liquidate  
7 those claims. It is certainly possible that further fact investigation will cause the Trustee to assert  
8 claims against other officers or directors, but no decision has been made at this time to do so.  
9 Finally, certain claims (such as the complaint that Salyer converted SK Foods' corporate  
10 opportunities and violated his fiduciary obligations by transferring the wastewater land to  
11 affiliates) may be resolved in a manner that does not require tender of a claim under the  
12 insurance policy – i.e., because title to that land is quieted in favor of the Trustee. In other  
13 words, granting relief from stay at this juncture will force the estate to expend significant sums  
14 defending the estate's rights in the Policies before it is clear that the Policies would in fact be a  
15 source of recovery for creditors.

16 16. Similarly, it should be noted that the Third, Fourth, and Eighth causes of action in  
17 Allied's draft Rescission Complaint seek a declaration that SK Foods and the would-be co-  
18 defendants are liable to Allied for any payments it may make under the Policies. *See* Rescission  
19 Complaint at 37:11-38:7; at 39:8-24. In other words, Allied is seeking relief from stay to  
20 liquidate a *pre*-petition claim against the estate. In light of the fact that a trustee has a duty to  
21 object to claims only when a purpose would be served, 11 U.S.C. § 704(a)(5), the Trustee (or the  
22 trustee of the liquidating trust), may elect not to object to any claim in light of the size of the  
23 filed claim, the size of the claims pool, and the amount of assets available for distribution.  
24 Granting relief from stay now will force the estate to incur substantial fees and costs without  
25 knowing whether such an expenditure of funds to defend against the claim is warranted.

26 *Continued from previous page*

27 any other officer or director of the Debtors' general or limited partners. *See* Plan at Art.  
28 1.51 and 1.71.

**C. The Balance of Hardships Favors The Estate**

17. The balance of the hardships tips in favor of the Debtors' estates. If the Court grants stay relief, the Debtors estates would be required to participate in significant federal or state court litigation at a critical juncture in these Bankruptcy Cases but without knowing if an expenditure of those funds is justified in light of any recovery the estate could obtain from the Policies, or the size of any potential unsecured claim Allied may be able to assert. On the other hand, Allied does not appear to be facing the prospect of paying any claims under the Policies in the near term since it has denied coverage for all claims made under the Policies, and – to the best of the Trustee's knowledge – no insured or claimant has filed a legal action challenging the denial of coverage. Although Allied may desire a "speedy resolution of their claims" (Motion, p. 7 at 23), any burden on Allied resulting from a delay in bringing a rescission action against the Debtors is clearly outweighed by the burden on the Debtors' preparation and participation in a trial. *See In re Comdisco*, 271 B.R. 273, 277 (Bankr. N.D. Ill. 2002) (noting that "[t]he automatic stay almost always delays litigants. That, after all, is its purpose, and the reason they call it a 'stay.'").

18. Accordingly, the balance of the hardships tips in favor of the Debtors. The Trustee submits that the stay should remain in effect until such time as the Trustee, any successor or assignee under the Plan, or another insured commences an action against Allied for wrongful denial of coverage under the Policies. Until then, a proceeding seeking a declaration of its rights to rescind is merely academic.

**D. Granting Relief From Stay Will Not Promote Judicial Economy**

14. Allied's Rescission Action has not yet been filed, and as such, there is no currently pending litigation. Should an insured or claimant file an action seeking to compel Allied's performance under the Policies, this Court is nonetheless equipped to address any issues of California state law which may arise. Additionally, this Court is already familiar with the parties and the factual core of the case, including the adversary proceedings the Trustee has commenced against other insureds that could spawn claims that are covered under the Primary and Excess Insurance Policies. As such, judicial economy would be promoted by the same court

1 deciding the underlying insured v. insured claims and also deciding any related coverage  
2 disputes.

3 15. The Ninth Circuit has held that a debtor's insurance policies are property of the  
4 estate. *Minoco Group of Cos., Ltd. v. First State Underwriters Agency of New Eng. Reins. Corp.*  
5 (*In re The Minoco Group of Cos., Ltd.*), 799 F.2d 517, 519 (9th Cir. 1986); *see also Groshong v.*  
6 *Sapp (In re Mila, Inc.)*, 423 B.R. 537, 543 (9th Cir. BAP 2010). Indeed, a "liability policy of the  
7 debtor . . . is a valuable property of the debtor [and] . . . may well be the most important asset of  
8 the estate." *Asbestosis Claimants v. American S.S. Owners Mut. Protection & Indem. Ass'n (In re*  
9 *Prudential Lines, Inc.)*, 170 B.R. 222 (S.D.N.Y. 1994), *rev'd on other grounds*, 533 F.3d 151  
10 (2d. Cir. 2008) (*citing A.H. Robins Co., Inc. v. Piccinin*, 788 F.2d 994, 1001 (4th Cir. 1986)).

11 16. Additionally, while the case law is not uniform, several courts have found that  
12 insurance coverage disputes are "core" proceedings under 28 U.S.C. § 157(b). *See Green v.*  
13 *Mass. Casualty Ins. Co.*, 269 B.R. 782, 787 (N.D. Ill. 2001) (noting that the validity of insurance  
14 policies is directly related to the debt discharge and is therefore properly considered a core  
15 proceeding); *see also Valley Forge Plaza Assocs. v. Fireman's Fund Ins. Cos.*, 107 B.R. 514,  
16 518 (E.D. Pa. 1989) (holding that "preservation of an insurance contract is a matter concerning  
17 the administration of the estate within the meaning of § 157(b)(2)(A)" and therefore "is a core  
18 proceeding"); *In re Heaven Sent, Ltd.*, 50 B.R. 636, 638 (Bankr. E.D. Pa. 1985) (holding that  
19 "the question of preservation of insurance in a chapter 11 proceeding is directly related to the  
20 administration of the estate under § 157(b)(2)(A), thus giving us jurisdiction to enter a final order  
21 on the action before us"); *Prudential Lines*, 170 B.R. at 231 ("because of the significance  
22 insurance coverage issues often have in a bankruptcy proceeding it is proper under certain  
23 circumstances for a bankruptcy court to adjudicate such matters"); *Home Ins. Co.*, 889 F.2d 746,  
24 748 (7th Cir. 1989), *vacated on other grounds*, 963 F.2d 1023 (7th Cir. 1992) (holding that a  
25 "policy of insurance is an asset of the estate, and a request to determine its validity with respect  
26 to the debtor is a 'core proceeding' over which a bankruptcy judge has jurisdiction." As here,  
27 *Home Ins. Co.* involved an action to determine whether an insurance policy was void because it  
28 was issued on the basis of alleged false statements.



1           17. Even if the insurance coverage dispute at issue here was deemed to be “non-core,”  
2 this Court is still the appropriate forum for an action against the Debtors. Allied argues that  
3 judicial efficiency will be promoted by trying their proposed Rescission Action in a non-  
4 bankruptcy forum because the Bankruptcy Court does not have authority to enter a final  
5 judgment resolving the insurance dispute, and that such judgment may only be entered by the  
6 district court. (Motion, p. 7 at 15-17). However, “‘the exception would swallow the rule’  
7 because judicial economy and efficiency would then never be promoted when a bankruptcy court  
8 hears a non-core issue.” *Ha-Lo- Indus., Inc. v. Fed. Ins. Co. (In re Ha 2003, Inc.)*, 2004 U.S.  
9 Dist. LEXIS 4674, \*8 (N.D. Ill. 2004) (citation omitted). In *Ha 2003*, the court held that judicial  
10 economy and efficiency would be hindered by trying the insurance coverage dispute in a non-  
11 bankruptcy forum because the Bankruptcy Court is already familiar with the parties, the factual  
12 core of the case, and many of the coverage issues involved. *Id.* The court further held that the  
13 efficiency and uniformity in the administration of the Bankruptcy Court proceedings would be  
14 harmed by trying the insurance dispute action in a non-bankruptcy forum. *Id.* at \*8-9. The same  
15 reasoning holds true in the present case.

16           18. Accordingly, for this additional reason, Allied has failed to demonstrate “cause”  
17 for relief from the automatic stay.

18           **E. Any Purported Waiver of the Stay Is Unenforceable**

19           21. Numerous courts have held that prepetition waivers of bankruptcy benefits,  
20 including waivers of the automatic stay, are unenforceable. *See In re Cole*, 226 B.R. 647, 652  
21 (9th Cir. BAP 1998); see also *Fallick v. Kehr (In re Fallick)*, 369 F.2d 899, 904 (2d Cir. 1966)  
22 (stating that advance agreements to waive the benefits of bankruptcy are void); *In re Weitzen*, 3  
23 F. Supp. 698, 698 (S.D.N.Y. 1933) (“The agreement to waive the benefit of bankruptcy is  
24 unenforceable. To sustain a contractual obligation of this character would frustrate the object of  
25 the Bankruptcy Act . . . .”); *In re Shady Grove Tech Ctr. Assocs. Ltd. P’ship*, 216 B.R. 386, 390  
26 (Bankr. D. Md. 1998) (“self-executing clauses in pre-petition agreements purporting to provide  
27 that no automatic stay arises in a bankruptcy case are contrary to law and hence unenforceable,  
28 and . . . self-executing clauses in pre-petition agreements . . . to vacate the automatic stay are

likewise unenforceable."); *In re Southeast Fin. Assocs., Inc.*, 212 B.R. 1003, 1005 (Bankr. M.D. Fla. 1997) (recognizing that a prepetition waiver of bankruptcy benefits is not self-executing or binding on third parties); *In re Tru Block Concrete Prods., Inc.*, 27 B.R. 486, 492 (Bankr. S.D. Cal. 1983) ("It is a well settled principal that an advance agreement to waive the benefits conferred by the bankruptcy laws is wholly void as against public policy"); *In re Pease*, 195 B.R. 431, 435 (Bankr. D. Neb. 1996) (concluding that "any attempt by a creditor in a private pre-bankruptcy agreement to opt out of the collective consequences of a debtor's future bankruptcy filing is generally unenforceable. The Bankruptcy Code pre-empts the private right to contract around its essential provisions, such [as] those found in 11 U.S.C. § 362.").

22. Accordingly, any purported waiver or release of the automatic stay, or waiver of the right to oppose Allied's motion for relief from the automatic stay, by the Debtors is void and unenforceable.

WHEREFORE, the Trustee respectfully requests that the Motion be denied.

Dated: June 9, 2010

SCHNADER HARRISON SEGAL & LEWIS LLP

/s/ Kevin W. Coleman

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